Chapter 6: Economies in Transition

Economic systems: is a set of institutions for allocating resources and making choices to satisfy human wants.

Resource allocation is the assignment of resources to specific tasks to determine the basic economic choices, which are what to produce, how to produce, and for whom to produce for.

1- What and how much will be produced?
   In a market system the forces and interaction of supply and demand for each commodity determines what and how much to produce. Prices are the reflection of the scarce resource.

2- How will it be produced?
   The problem is what combination or mix of productive resources or inputs should be used in order to produce a desired product. That is to use more labor and less capital or vice versa, to more skilled labor and less units of unskilled labor or vice versa. In a price system, the combination or mix of inputs should be based on least-combination method. This method maximizes the profit and minimizes the cost. In other words, the least-cost combination is the level of input use that produces a given level of output at minimum cost. On the other hand, in a price system, competition will force firms to use the least cost combination method. Competition means there are large numbers of buyers and sellers in each market that are acting independently. Therefore, those firms that use the least cost combination method will be able to lower the price of their products and make a profit.

3- For whom it will be produced?
   The distribution of goods and services depends on the distribution of money income. Money income, in turn, depends on the quantity, quality and the types of resources and the prices of the product. Therefore, the distribution of finished goods and services will depend on consumers’ ability and willingness to pay the market price. In fact, relative prices ration the available resources, goods and services.

   Resources may be allocated by tradition, by markets, or by planning. In a traditional economy, goods and resources are allocated according to historical patterns. However, in a market economy, goods and resources are allocated according to the decisions of individual producers and consumers.

   In a Planning economy, goods and resources are allocated according to the central directions of a government agency.

1- Pure Capitalism: is an economic system in which individuals own productive resources, and those individuals can use resources in whatever manner they choose, subject to common productive legal restrictions. In other words, it is the private ownership of productive resources including labor and the use of market mechanism and prices to coordinate economic activities. This system concerns the three Ps, prices, profits, and private property. This economic system is sometimes referred to as a laissez-fair system. Producing those goods and resources that people will buy at profitable prices will yield efficiency. In fact, advocates of this system argue that it encourages efficiency, stability of output and employment and economic growth. The government is limited to provide certain public goods such as national defense, basic education, and legal systems.

2- The Command Economy (Communism) is a system in which workers are motivated to contribute to the community interest rather than working to promote self-interest. It is a system where government mostly decides what and how much to produce how it will be produced, and who will get them. That is by public ownership of all property resources and economic decision making process through centrally planned economy. For example, all major decisions concerning the level of resource use, the distribution of output and income, and the organization of output are directed and determined by the central planning board of the government. Incentives under this system tend to yield in an inefficient use of resources.
3- **Mixed Economy (Welfare Capitalism)** is an economic system in which decisions about how resources should be used are actually made partly private sector and partly by public sector (ex. U.S., Japan, and others)

   It is a system where most wealth is generated by businesses, but the government plays a major part in allocating resources. The resources are obtained from business and workers in the form of taxes.

4- **Socialism** is an economic system in which the state owns a major share of the productive resources, except for labor (Sweden, and some other European countries).

**Frontier capitalism:** Economics in transition from state ownership and control of resources to a system private ownership system in which the price system is used for resource allocation.

**Pure Capitalism and the Market System:** Under this system resources flow into activities that are most profitable and out of those activities that are not as profitable (losses). Therefore, profits determines what to produce and in turn what to produce will be determined by what people will buy at profitable prices.

   A- **Private property:** private individuals and firms own resources. Property rights apply intellectual property through patents and copyrights. This encourages people to innovate, invent new products and seek for an exchange.

   B- **Freedom of enterprise and choice:** Resource owners including labor are free to move in and out of industries and geographical location. Private owners have the right to obtain economic resources, and to organize those resources. Resources move to areas of higher profits. Owners can manage their property and money and workers are free to choose jobs in which they are qualified. Consumers decide through their choices what to produce. Workers maximize their satisfaction by finding the best jobs that can fit their qualification.

   C- **Market price system:** Prices are determined by the interaction of demand and supply. In a market system, prices are a communicational system through which producers and consumers carry out their decisions.

   D- **Risk takers** are rewarded by higher profits but those who takes bad business decisions will suffer losses.

   E- **Decisions about what and how much should be produced, how it should be produced, and for whom it should be produced** are decentralized and made by individuals who are acting independently. That is individuals are self-interest motivated and therefore, firms maximize the profit and minimize the cost. Consumers also maximize the satisfaction of goods and services b seeking the lowest price. Workers maximize their utility(satisfaction), by finding the best jobs that can fit their qualifications.

   F- **Limited government intervention:** There is little need for government intervention under this system, and therefore the economy is self-regulating and self-adjusting mechanism. The government is limited to provide certain public goods such as defense, legal system, and protection of property rights.

There are some other characteristics
1- The use of advanced technology 2- specialization, 3- the use of money.

All industrialized economies experienced in technological development and the extensive of capital goods. In fact, this technological development is the result of competition, freedom of choice, and self-interest. Therefore, risk takers are rewarded by higher profits for their new products.

**Specialization:** Focusing an individual’s efforts on a particular task.

The three Ps of pure capitalism are prices, profits and private property.
**Frontier Capitalism** there are four states involve in the development of this process.

Stage I:  - the central government does not control resource allocation  
   - the black market emerges and criminal activity and corruption increase

Stage II – small businesses flourish, but commercial laws are not established  
   - the lack of protection of the property rights

Stage III – slow economic growth though it is not measured well.  
   - the development of small financial markets (foreign investment)  
   - a clear cut of commercial laws are established.

Stage IV: - more attraction of the direct foreign investment  
   - more privatization process continues and more commercial laws are better established

Russia and its former satellites
Two-thirds of Russia’s economy is now in private hands and the private sector accounts for more than half of Russian output.
The Russian tax system is so high, that is enforced, they would amount to a confiscation to of wealth. Therefore, exchanging goods for goods (Barter) are traded nearly 40 per cent of industrial transactions to avoid taxes. The solution to this problem is that the tax system should be simplified and judiciary system and police must be enforced.

Chinese Economy: China has some form of command socialism, but the share of the government in economic activity is declining gradually. In 1978 reforms were implemented in agriculture. In the 1980s central planning was relaxed and a large number of government run enterprises were privatized. Therefore, the state-owned sector dropped from almost 70 percent of industrial production in the mid 1980s to less than 40 percent by 1996.
Questions:
1- A price system is an economic system in which
   A) resource allocation is decided by bureaucrats
   B) commands from government planners are used to answer the three basic economic questions
   C) prices for all basic commodities are set by federal mandate
   D) Prices are constantly changing to reflect changes in supply and demand for different commodities

2- In a market economy the least-cost combination of inputs is used to produce a good because
   A) producers are less concerned with conserving natural resources in a market economy than in any other economic system
   B) it minimizes profits
   C) it maximizes profits
   D) It generates cheaply made goods that will wear out quickly, government additional sales in the future.

3- In a market system, goods will typically go to those who
   A) need them the most
   B) want them the least
   C) have the willingness and ability to purchase them
   D) are the best informed about where the goods can be purchased

4- Which of the following is not an essential feature of pure market capitalism?
   A) private property rights exist
   B) prices are used to allocate resources
   C) Nationalization of large firms is very common
   D) Resources are free to move in and out of industries and geographic locations

5- A mixed system is an economic system in which
   A) scarcity is controlled by rationing
   B) production is controlled by the government but consumers are free to by whatever goods they wish
   C) decisions about how resources should be used are made partly by the private sector and partly by the public sector

6- The United States is an example of
   A) a pure market capitalist system
   B) command socialism
   C) a mixed economy
   D) market capitalism

7- The economic s

8- System in the Republic of China is a form of
   A) Pure capitalism
   B) command socialism
   C) Laissez-fair
   D) market socialism

9- Privatization refers to
   A) the sale of state-owned businesses to unions
   B) the sale of state-owned businesses to the private sector
   C) the sale of state-owned business businesses to foreigners only
   D) the sale of state-owned businesses to the military
10- An economic system in which the state owns the major share of productive resources, except for labor is known as
   A) Capitalistic system
   B) a laissez-fair system
   C) Socialist system
   D) a price system

11- Two of the most important aspects of frontier capitalism are
   A) increasing government planning and getting rid of foreign investors
   B) developing a legal system and selling off state-owned businesses
   C) having the state buy up small businesses and having the government crack down on petty crime
   D) reducing government corruption and expanding the black market